

Industry: Tobacco

Symbol: AMB, BTI, MO, RN, UST

Subject: Tobacco Stocks' Earnings Outlook; July Monthly

TOBACCO STOCKS' EARNINGS OUTLOOK

American Brands

We expect the second quarter to be a difficult quarter for American Brands (as well as the other cigarette manufacturers) due to the intense competition in the U.S. tobacco industry and thus we estimate down earnings. However, poor results will be somewhat offset by a non-recurring pretax gain of \$25 million in the second quarter, as announced on June 29, as a result of its agreement with B.A.T Industries to exchange brands in Europe. Further, the results will be pressured by the exchange rate of sterling to U.S. dollars, which was \$1.81 in the 1992 second quarter and is about \$1.50 now. British profits contribute about 30-40% of AMB's total operating income. Our earnings per share estimate, or best guess, for the second quarter is \$0.85 versus \$0.94 fully-diluted, excluding the non-recurring gain.

B.A.T Industries

As announced on June 29, B.A.T will gain a pretax profit of approximately 135 million pounds sterling, less an 8 million pounds sterling trading profit foregone, under its agreement with AMB. The company also announced that 1993 first half trading profit will be affected by about 50 million pounds sterling to "deload" its Kool brand, which has not been directly involved in a price war, but has been affected by trading down by consumers. We believe that results from B & W, the U.S. unit, will be worse than expected, and that the international segment will not show the pick-up that was anticipated due to continued pressure in the German market from the roll-your-own products (should abate in late 1993 due to B.A.T.'s introduction of HB roll-your-own). On the insurance side, Eagle Star will be impacted by about L25 million due to claims from the IRA bombing. We are estimating pretax profit to be about 690 million pounds sterling in the first half, or about 330 million pounds sterling for the second quarter versus 414 million pounds last year, down 20%, excluding the non-recurring gain.

Philip Morris

Our second quarter estimate for Philip Morris is \$1.17 per share versus \$1.48, down 21%, due to the price competition

in the U.S. We are expecting a 20% decline in U.S. cigarette volume due to a wholesale inventory run-off of full-priced cigarettes (primarily Marlboro). Further, U.S. profits will be pressured by price promotions in both the full-priced and value-priced categories. Early results on

early to tell if this represents stocking up by consumers and retailers at cheap prices--or if the trends have sustainably changed. International tobacco and overall food profits should be above trendline due to recoveries in several markets. Unfortunately, we don't believe investors will pay much attention to these areas during the price war.

RJR Nabisco

For the second quarter, we estimate RN could report earnings per share of \$0.12 versus \$0.16 last year, down 25%. Again, the major pressure on earnings is the price war in the U.S. cigarette market. We believe RN's domestic unit volume declined 5-10% in the quarter (not as much as MO because RN didn't need to run-off wholesale inventory). Our estimate for international tobacco results is a trendline 15% increases. We believe Nabisco profits could be up 12-14% (excluding ready-to-eat cereal profits from 1992 numbers as this division was sold in the 1993 first quarter). This is above average performance for the division due to good biscuit volumes (we estimate up 1-3%), productivity gains, and contributions from acquisitions.

UST

Overall, we think UST will have a good quarter and are comfortable with our earnings per share estimate of \$0.40 in the second quarter versus \$0.35. In the quarter, UST introduced two new products, Skoal Long Cut in cherry and spearmint, which have been doing very well and may help volume. As previously noted, the company changed shipping patterns in the first quarter from delivery twice per week to once per week. The company attributed the volume decline in the first quarter in part to this change, because many wholesalers were slow to understand the change and underordered. In the second quarter, UST says everything was pretty much back on line, although some shipping disruptions did occur, but these should not be noticeable. A difference in comparable results will be the exclusion in 1993 of Zig-Zag, which was sold in the 1993 first quarter. In the 1992 second quarter, Zig-Zag contributed \$8.6 million in net sales and \$5.9 million in gross profit. The company has indicated that it will probably not raise prices for its products the first week in July as it does each year and instead holdout for a few months due to the introduction of the new products.

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